



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)	No. G 03-84
)	
The Financial Examination of)	FINDINGS, CONCLUSIONS,
MSC LIFE INSURANCE COMPANY)	AND ORDER ADOPTING REPORT
A Domestic Insurer.)	OF
)	FINANCIAL EXAMINATION

BACKGROUND

An examination of the financial condition of **MSC LIFE INSURANCE COMPANY** (the Company) as of December 31, 2002, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a life and disability insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and comments and recommendations was transmitted to the Company for its comments on July 9, 2003. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 6 through 25 of the report.

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **MSC LIFE INSURANCE COMPANY** and to order the Company to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented the Instructions and Recommendations prior to the date of this order. The Instructions and Recommendations in the report are an appropriate response to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, this being the Instructions and Comments and Recommendations contained in the examination report on pages 6-11.

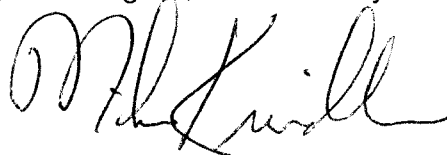
1. The Company is ordered to create an appropriate, written and permanent authorization record for each investment, signed by the appropriate individual, in compliance with RCW 48.13.350. Instruction 1, Examination Report, page 6.
2. The Company is ordered to maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D and is ordered to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner. Instruction 2, Examination Report, page 7.
3. The Company is ordered to formally draft an intercompany agreement with Premera and/or Premera Blue Cross describing services rendered and the reimbursement methodology for those services. The Company is also ordered to revise or amend the Restated Intercompany Tax Sharing Agreement so that the Company is a signer to both agreements. In addition, the Company is ordered to submit the contract to the Washington State Office of Insurance Commissioner (OIC) before its execution in compliance with RCW 48.31B.030(1)(b)(iv). Instruction 3, Examination Report, page 7.
4. The Company is ordered to ensure that conflict of interest questionnaires are received from appropriate officials and reviewed, and that the results of the review

be annually reported to the Board, as required by the Company's Conflict of Interest Policy and in compliance with RCW 48.05.370. Instruction 4, Examination Report, page 8.

5. The Company is ordered to include in future filings all required annual statement disclosures and to correctly answer all annual statement questions in compliance with WAC 284-07-050(2) and RCW 48.05.250. Instruction 5, Examination Report, page 8.
6. The Company is ordered to have the applicable Tax-Sharing Agreement approved by the Company's Board of Directors and to notify the OIC prior to implementation in compliance with RCW 48.05.250 and RCW 48.31B.030(1)(b)(iv). Instruction 6, Examination Report, page 9.
7. The Company is ordered to include its transactions with affiliates in its future filings of its Annual Statement Schedule Y, Part 2, including those related to management agreements, service contracts and intercompany tax-sharing agreements in compliance with RCW 48.05.250. Instruction 7, Examination Report, page 9.
8. The Company is ordered to hold a shareholders' meeting, at least annually in compliance with RCW 48.07.040. Instruction 8, Examination Report, page 9.
9. The Company is ordered to maintain five board members in compliance with RCW 48.06.200(5) and its Bylaws. Instruction 9, Examination Report, page 9.
10. The Company is ordered to revise its custodial agreement to ensure that it contains a clause requiring the custodian to notify the commissioner if a custodial agreement is terminated or if all of the custody account's assets have been withdrawn. The Company is also ordered to ensure that the custodial agreement contains a clause requiring the custodian to maintain adequate insurance protection for its custodial assets in compliance with the NAIC Financial Condition Examiners' Handbook. Comments and Recommendations 1, Examination Report, page 10.
11. The Company must advise its independent auditors that the auditors' report must reflect Company representations from the annual statement filed with the state. Comments and Recommendations 2, Examination Report, page 10.
12. The Company is ordered to comply with its Bylaws and hold regular quarterly meetings of its Board of Directors. Comments and Recommendations 3, Examination Report, page 11.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Tumwater, Washington, this 27th day of August, 2003.

A handwritten signature in black ink, appearing to read "Mike Kreidler", written in a cursive style.

MIKE KREIDLER
Insurance Commissioner

SCANNED

SENT VIA FACSIMILE & ORIGINAL MAILED

July 9, 2003

RECEIVED
JUL 11 2003

INSURANCE COMMISSIONER
COMPANY SUPERVISION

James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
Office of Insurance Commissioner
State of Washington
P.O. Box 40255
Olympia, WA 98504-0255

RE: Examination Report of MSC Life Insurance Company
As of December 31, 2002

Dear Mr. Odiorne:

This letter is in response to the draft Examination Report of MSC Life Insurance Company ("MSCL") dated June 17, 2003. The Report's instructions and recommendations are set forth herein in *italics* for convenience of reference.

INSTRUCTIONS

1. Approval of Investment Transactions

MSCL is again instructed to create an appropriate, written and permanent authorization record for each investment, signed by the appropriate individual, in compliance with RCW 48.13.350

Response: MSCL will institute processes consistent with RCW 48.13.350.

2. Records and Accounts

The Company is instructed to maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D and is instructed to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner.

Response: Subsequent to the completion of field work and receipt of the draft Examination Report, MSCL produced amortization schedules and documentation supporting the recalculation of the amortization utilizing Bloomberg. MSCL will discuss this documentation with the lead examiner on July 11, 2003, and believes that the instruction may no longer be necessary.

3. Intercompany Agreements

The Company is instructed to formally draft an intercompany agreement with Premera and/or Premera Blue Cross describing services rendered and the reimbursement methodology for those services. The company is also instructed to revise or amend the Restated Intercompany Tax Sharing Agreement so that the Company a signer to both agreements. In addition, the company is instructed to submit the contract to the Office of Insurance Commissioner before its execution, per RCW 48.31B.030(1)(b)(iv).

Response: As a point of clarification, there are two tax sharing agreements between affiliates in the PREMERA holding company system. The original parties to the Restated Intercompany Tax Sharing Agreement were PREMERA, Blue Cross of Washington and Alaska (BCWA) and MSC of Eastern Washington (MSC). In 1998, MSC merged into BCWA and BCWA changed its name to Premera Blue Cross (PBC). Upon completion of that transaction, PREMERA and PBC became the parties to that agreement. On September 6, 2001, PBC filed this agreement with the Office of Insurance Commissioner in its initial Registration Statement for the period ending December 31, 2000.

MSCL recognizes that corporate records evidencing MSCL's submission of Form D filings for the Intercompany Cost Allocation Agreement or Subsidiary Tax Sharing Agreement were not available. However, this lack of availability should not be presumed to mean that such filings did not occur. Both of those agreements were previously filed by MSCL's affiliate, States West Life Insurance Company, with the Office of Insurance Commissioner. MSCL will resubmit Form D filings for each agreement.

4. Conflict of Interest

RCW 48.05.370 states: "Officers and directors of an insurer...shall be deemed to stand in a fiduciary relation to the insurer, and shall discharge the duties of their respective positions in good faith, and with that diligence, care and skill which ordinary prudent men would exercise under similar circumstances in like positions." The company is instructed to ensure that conflict of interest questionnaires are received from appropriate officials and reviewed, and that the results of the review be reported to the Board annually, as required by the Conflict of Interest Policy.

Response: MSCL notes that RCW 48.05.370 sets forth the standards of conduct applicable to officers and directors of insurers. In addition to other requirements, RCW 48.05.370 effectively required that directors disclose any conflicts of interest as they arise and are related to matters before the MSCL Board and, if appropriate, recuse themselves in the discussions and/or voting

on such matters. In fact, Article 6 of MSCL's articles of incorporation contemplates such disclosure by directors.

The PREMERA holding company system's Conflict of Interest Questionnaire Policy requires all MSCL directors and officers to complete a conflict of interest questionnaire annually. However, that policy does not require annual reporting of conflicts of interest to the MSCL board. Instead, it requires Premera's General Counsel to report the results solely to the PREMERA and Premera Blue Cross boards of directors at the annual board meeting. Since state law does not require such reporting to MSCL's board, MSCL believes that its current processes of reporting conflicts of interest related to matters presented before the MSCL board meets the intent of RCW 48.05.370.

5. Annual Statement-Notes to Financial Statements

WAC 284-07-050(2) requires Washington insurers to file an annual statement and adhere to the appropriate Annual Statement Instructions. In future filings the Company is instructed to comply with the Annual Statement instructions and to include all required disclosures.

In accordance with RCW 48.05.250, which requires annual filing of a "true statement of its financial condition, transactions and affairs...", the Company is instructed to correctly answer all questions in future filings.

Response: For future annual statements, MSCL will comply with RCW 48.05.250 and WAC 284-07-050(2).

6. Board Approval of Tax Sharing Agreement

In accordance with RCW 48.05.250, which requires the Company to file a "true statement of its financial condition, transactions, and affairs", the Company is instructed to have the Restated Intercompany Tax Sharing Agreement approved by the MSC Life Insurance Company Board of Directors.

Response: As explained in Item 3 above, MSCL is not a party to the Restated Intercompany Tax Sharing Agreement. Instead, it is a party to the Subsidiary Tax Sharing Agreement. MSCL recognizes that corporate records demonstrating that the board had previously approved the Subsidiary Tax Sharing Agreement were not available. However, the lack of availability of such documentation should not presume that the board did not take appropriate action. The Subsidiary Tax Sharing Agreement, which is utilized currently by many of the affiliates within the PREMERA holding company system, will be submitted to the MSCL board for approval.

7. Annual Statement Schedule Y, Part 2

In accordance with the Annual Statement Instructions, which require reporting of transactions between insurers and non-insurers within the holding company system, including those related to management agreements, service contracts and intercompany tax-sharing agreements, the Company is instructed to include its activity with affiliates in Annual Statement Schedule Y, Part 2.

Response: MSCL will include intercompany activity in future annual statements.

8. Shareholder Meetings

The Company is instructed to hold a shareholder's meeting, at least annually as required by RCW 48.07.040 which states, "Each incorporated domestic insurer shall hold an annual meeting of its shareholders...in accordance with its bylaws for the purpose of receiving reports of its affairs and to elect directors."

Response: MSCL recognizes that corporate records concerning shareholder meetings prior to 1999 were not available. However, the lack of availability of such records should not presume that shareholder meetings did not take place. Nevertheless, the company will hold annual shareholder meetings in accordance with state law and its bylaws.

9. Number of Board Members

The Company is instructed to maintain five board members in compliance with RCW 48.06.200(5) and its Bylaws.

Response: All directors of MSCL are employees of Premier Blue Cross. When their employment ceases, they resign their position as a director of MSCL. Nomination and ratification of a successor director take time, so MSCL may have less than five board members for short periods of time. MSCL will endeavor to fill such vacancies promptly.

COMMENTS AND RECOMMENDATIONS

1. Custodial Agreement

WAC 284-07-050(2) requires Washington insurers to file an annual statement and adhere to the appropriate Annual Statement Instructions. This implies that all such information supplied is accurate and complete. Therefore, the Company should revise its custodial agreement to comply with the NAIC Examiners Handbook to:

- *Ensure that the custodial agreement contains a clause requiring the custodian to notify the commissioner if a custodial agreement is terminated or if all of the custody account's assets have been withdrawn (2003 NAIC Financial Condition Examiner's Handbook, Part 1 – General, IV. Conducting Examinations, Section J, Paragraph 2.f.).*
- *Ensure that the custodial agreement contains a clause requiring the custodian to maintain adequate insurance protection for its custodial assets (NAIC Financial Condition Examiner's Handbook, Part 1 – General, IV. Conducting Examinations, Section J, Paragraph 2.k.).*

Response: MSCL will negotiate amendments to the existing custodial agreement to (1) ensure that the custodian notifies the commissioner in the event that the agreement is terminated or all of the assets have been withdrawn and (2) require adequate insurance protection for MSCL's custodial assets.

2. Authorized Stock

The auditor's report is intended to reflect Company representations from the annual statement filed with the state. Therefore, it is recommended that the Company advise its independent auditors of this discrepancy.

Response: On April 29, 2003, MSCL advised its independent auditors of this discrepancy.

3. Board Meetings

Since Article 3.7 of the Bylaws, requires regular meetings at least quarterly, it is recommended that the Company hold quarterly meetings of the Board of Directors or amend the Bylaws.

Response: MSCL will amend its bylaws to eliminate the requirement for quarterly meetings.

MISCELLANEOUS REPORT CORRECTIONS

1. On page 12, please remove C. Marion Butler, Jr. as the Chairman of the Board as of December 31, 2002. He resigned that position effective October 16, 2002.
2. On page 13 in the second paragraph, MSCL has filed its own annual registration statement as required by the state's holding company act and any amendments thereto as required by law.
3. On page 15 under OFFICERS AND EMPLOYEES WELFARE AND PENSION PLAN, MSCL did have employees eligible for welfare plans in the fourth quarter of 2002.
4. On page 15 under INTERNAL SECURITY, MSCL would like to clarify that Premera Blue Cross has an internal audit department that provides auditing services to all affiliates within the PREMERA holding company system.

Mr. James T. Odiorne

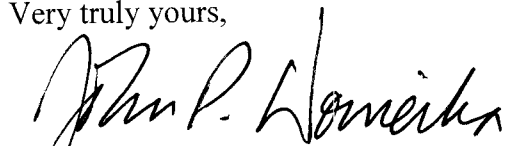
July 9, 2003

Page 6

5. On page 16 under PREMERA AND SUBSIDIARIES INSURANCE SUMMARY, the Commercial General Liability coverage through Wausau has a \$1,000,000 occurrence limit that was omitted from the chart.
6. On page 18 under SUBSEQUENT EVENTS, MSCL has a sixty six-month lease for office space in Scottsdale Arizona. MSCL was not required to pay rent for the first six months of the lease.

Thank you for allowing MSCL the opportunity to respond to the instructions and recommendations contained in the draft Examination Report as well as correct factual material presented therein. If you would like to discuss these matters in more detail, please contact Juli Bowen at (425) 918-5438.

Very truly yours,

A handwritten signature in black ink, appearing to read "John P. Domeika". The signature is fluid and cursive, with the first name "John" being the most prominent part.

John P. Domeika
Senior Vice President & General Counsel

cc: Michael G. Watson, Chief Deputy
Patrick H. McNaughton, Chief Examiner